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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 257

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THE MIDLAND MUTUAL LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 4, 1936

CERTIORARI GRANTED OCTOBER 12, 1936

SUPREME COURT OF THE UNITED STATES

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104782—36——1

Before United States Board of Tax Appeals

Docket No. 71730

THE MIDLAND MUTUAL LIFE INSURANCE CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances:

For Petitioner: Carl J. Purpus, Esq., F. J. Wright, Esq.,
For Respondent: A. Carnduff, Esq.

Docket entries

1933

May 1—Petition received and filed. Taxpayer notified. (Fee paid.)
May 1—Copy of petition served on general counsel.
June 12—Answer filed by general counsel.
June 21—Copy of answer served on taxpayer.
Nov. 8—Hearing set Dec. 14, 1933.
Nov. 13—Motion to place on circuit calendar for hearing in Columbus, Ohio, filed by taxpayer.
Nov. 14—Motion of 11-13-33 denied.
Dec. 14—Hearing had before Mr. Morris on merits—submitted. Appearance of F. J. Wright and stipulation of facts filed. Petitioner's brief due 1-15-34.
Dec. 20—Transcript of hearing of Dec. 14, 1933, filed.

1934

Jan. 12—Memorandum of authorities filed by general counsel.
Jan. 13—Brief filed by taxpayer. 1-15-34 copy served on general counsel.
Sept. 11—Memorandum opinion rendered—Logan Morris, Division 14. Judgment will be entered for the respondent.
Sept. 12—Decision entered—Division 14, Logan Morris.
Dec. 3—Supersedeas bond in the amount of $2,500.00 approved and ordered filed.
Dec. 3—Petition for review by U. S. Circuit Court of Appeals (6) with assignments of error filed by taxpayer.
Dec. 3—Praecipe filed.
Dec. 3—Statement of evidence lodged.
Dec. 4—Proof of service of petition and praecipe filed.
Dec. 13—Notice of lodgement of statement with hearing notice 12-26-34 filed.
Dec. 26—Hearing had before Mr. Black on approval of statement of evidence—referred to Mr. Morris for approval.
Dec. 27—Statement of evidence approved and ordered filed.

Before United States Board of Tax Appeals

Petition

Filed May 1, 1933

The above named petitioner hereby petitions for a redetermination of a deficiency assessment as set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (IT:AR:C–6–RWC–60D) dated March 3, 1933, and as a basis of its proceeding alleges as follows:

1. The petitioner, The Midland Mutual Life Insurance Company, is a corporation with its principal place of business in the Huntington Bank Building, Number 17 South High Street, Columbus, Ohio.

2. The Notice of Deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on March 3, 1933.

3. The tax in controversy is an income tax deficiency for the calendar year 1930 of $1,232.22.

4. The determination of tax set forth in said Notice of Deficiency is based upon the following errors:

(a) The commissioner erred in refusing to permit the petitioner to deduct from net income for the year 1930, and in adding to the net income of the petitioner for the year 1930 as interest received on mortgage loans the sum of $5,456.99.

3 5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) The taxpayer did not receive in the year 1930 interest on mortgage loans on properties Nos. 6, 7, 10, 11, 13, and 15 in the total amount of $5,456.99 as found and determined by the Commissioner, or any other amount. Said sum represents the total amount of interest due but unpaid to the taxpayer at the time of the foreclosure sales which was included in the bid price of the respective properties at such foreclosure sales. The books of the taxpayer do not show the receipt of such amount of interest on such mortgage loans in the year 1930 and the same does not constitute income in said year.

(b) At the time title to said properties was acquired by the taxpayer and said properties were transferred to the real estate accounts of the taxpayer there was not included in the book value of any of such properties any amount for accrued interest. At such time the book value of each of said properties included only the unpaid principal of the loan thereon and the actual disbursements that had been made on account of such properties by the taxpayer, including taxes and expenses at or prior to the acquisition of title, as the case may be, court costs and attorneys fees in connection with such foreclosure (see Exhibit A attached to the Commissioner's letter of March 3, 1933).

(c) Properties Nos. 6, 10, 11, and 13 are all located in the City of Detroit, Michigan. Under the laws of the State of Michigan

followed by the taxpayer in foreclosing mortgages in that state, the mortgagor is allowed one year from the date of the foreclosure sale within which he may redeem the property by paying to the purchaser the amount bid for the property at such sale, even though the amount of such bid be less than the total amount of the mortgagee's investment in the property. The purchaser cannot, under the law, acquire title until after the expiration of the redemption period. In the case of each of said properties the taxpayer (mortgagee) was the only bidder, and in order to protect itself from loss through redemption of the mortgaged premises, and entirely irrespective of the value of the property, the taxpayer was forced to bid at foreclosure sale the amount of its total investment therein, including principal amount, interest, taxes, court costs, attorney fees, and other charges then accrued. If the properties are redeemed during the redemption period, taxes and insurance premiums accruing during such period cannot, if paid by the mortgagee, be collected from the mortgagor.

(d) The mortgagee in mortgages on Michigan real estate does not acquire title to the mortgaged premises bid in at foreclosure sale until one year from the date of sale. Therefore, the value of the mortgaged property at the date of the acquisition of title should be considered rather than the value at the date of sale. The market values of the respective Michigan properties were substantially less in 1930 than on the respective dates of sale of sale properties. The petitioner denies that any interest income, based on the value of the property at any date, was or is received or subject to tax.

(e) Properties Nos. 7 and 15 are located in the Cities of Canton, Ohio, and Lima, Ohio, respectively. Under the laws of Ohio foreclosures are instituted by filing a petition and causing a summons to be issued thereon. At the expiration of the time for answer, if the mortgagor is in default for answer, or after hearing if answer is filed, a decree of foreclosure is entered. No redemption period is fixed by statute, but the court fixes a redemption period usually from three days to a week. Thereafter an order of sale issues to the sheriff of the county in which the premises are located who, after due advertisement thereof, offers the same for sale. Entirely irrespective of the value of the property, the mortgagee customarily bids the property at the lowest amount permitted by law so as to avoid the additional costs and expenses which would be incurred by readvertising and reoffering of said property for sale. In other words, the amount at which the property is bid in by the mortgagee has no relation to the value of the property, but the bid is made for the purpose of obtaining title promptly by the mortgagee and to avoid the additional costs and expenses above referred to.

(f) In all cases in determining market values, consideration should be given to the fact that the taxpayer would, on resale of the respective properties, be compelled to pay sales commissions which amount to 5% in Detroit, Michigan, and Lima, Ohio, and 4% in Canton, Ohio.

Wherefore the petitioner prays that this Board may hear the proceedings and redetermine the deficiency herein resisted and for such other relief to which the petitioner may be found to be entitled.

CARL J. PURPUS,
Counsel for Petitioner,
Huntington Bank Bldg., Columbus, Ohio.

5 *Duly sworn to by H. B. Arnold; jurat omitted in printing.*

Exhibit A to petition

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, March 3, 1933.

THE MIDLAND MUTUAL LIFE INSURANCE COMPANY,
12th Floor, Huntington Bank Building, Columbus, Ohio.

SIR: Your are advised that the determination of your tax liability for the year 1930, discloses a deficiency of $1,232.22, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928,
6 notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, If You Do Not Desire To Petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; Whereas If This Form Is Not Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By W. SHERWOOD,
Acting Deputy Commissioner.

Inclosures:
Statement
Form 870
Schedules 1 and 2
Exhibit A

Statement

IT:AR:C–6
RWC–60D

In re: The Midland Mutual Life Insurance Company, Columbus, Ohio

Income tax liability

Year	Income tax liability	Income tax assessed	Deficiency
1930	$30,945.54	$29,713.32	$1,232.22

The adjustments producing the result stated above are based on a revenue agent's report, a copy of which has been furnished you, and are explained in the attached schedules 1 and 2 and Exhibit A.

Careful consideration has been given to your protest dated October 31, 1932, filed with the internal revenue agent in charge, Cincinnati, Ohio, and to your protest executed February 2, 1933, addressed to the Commissioner of Internal Revenue, Washington, D. C.

The Midland Mutual Life Insurance Company. Year ended December 31, 1930

Schedule 1.—Adjustments to Net Income

Net income as disclosed by return		$247,611.00
As corrected		257,879.51
Net adjustment as computed below		$10,268.51
Unallowable deductions and additional income:		
(a) Interest on Mortgage loans	$5,456.99	
(b) Taxes	2,830.76	
(c) Interest on income tax refunds	2,282.81	
Total	$10,570.56	
Nontaxable income and additional deductions:		
(d) Interest on mortgage loans	302.05	
Net adjustment as above		$10,268.51

Schedule 1–A.—Explanations of Items

(a) Interest on mortgage loans.

Where a company forecloses a mortgage, upon which both principal and interest are due and unpaid, and buys in the property for the face value of the mortgage, it has received no gross income. (John Hancock Mutual Life Insurance Company, 10 B. T. A. 736.) However, if it is bid in at the face value of the mortgage, plus accrued interest and expenses the Bureau holds that the accrued interest should be accounted for as accrued. Where properties are ac-

quired from borrowers through deeds voluntarily made to the company, it is considered full satisfaction has been made of all principal and interest, and the accrued interest should be accounted for.

See exhibit A, last column, for details of computation made in accordance with the above.

(b) Taxes.

In real estate taxes deducted in return there was included as
8 deductions taxes paid at the end of the redemption period on property acquired in Michigan. These items should have been added to cost of properties, and are therefore disallowed as deductions. See exhibit A, column 5, for details.

(c) Interest on income tax refunds is taxable and is therefore restored to income.

(d) Interest on mortgage loans.

This item represents interest included in income in error. See exhibit A, next to last column for details.

Schedule 2.—Computation of Tax, 1930—Income Tax

Net income for taxable year	$257,879.51
Income tax 12%	30,945.54
Total previously assessed, No. 400245	29,713.32
Additional tax to the assessed	1,232.22

IT:AR:C-6
RWC-60D

Exhibit A to notice of deficiency

In re: The Midland Mutual Life Insurance Company, Columbus, Ohio

Real estate acquired year ended December 31, 1930

Property number	Mortgage loan number	Unpaid principal of loan	Taxes and expense prior to and at time of foreclosure, court costs, attorney fees, etc. (capitalized on books)	Taxes paid at expiration of period of redemption covering period of redemption (charged to "Real estate expense" in error)	Attorney fees charged legal expense in error. Not deducted on return—but should be included in cost basis of property	Cost basis	Accrued interest added to interest earned on books and return in error	Book value	How acquired	Bid price of a judicial sale	Accrued interest to date acquired	Interest included in income on return in	Interest to be added to taxable income
6	931	$8,500.00	$701.35	$304.86	$84.75	$9,590.96		[a] $9,148.35	Jud. sale	$10,192.08	$1,275.00		$601.12
7	1093	9,900.00	651.65			10,551.65		10,551.65	Jud. sale	11,000.00	897.60		448.35
8	1162	20,000.00				20,000.00		20,000.00	Jud. sale	22,000.00			
9	1371	28,225.00				28,225.00		28,225.00	Jud. sale	20,000.00	2,012.40		575.66
10	1350	15,000.00	772.07	628.15		16,400.22		[b] 15,772.07	Jud. sale	16,975.88	2,010.00		1,389.61
11	1326	15,000.00	1,200.53	536.89		16,737.42		[c] 16,200.53	Jud. sale	18,127.03	2,075.00		
12	807	5,053.25	1,000.09			6,653.34	$302.05	[d] 6,955.39	Jud. sale	6,560.00	302.05	$302.05	1,641.49
13	1470	34,200.00	2,046.22	1,360.86		37,607.08		[e] 36,246.22	Jud. sale	39,251.57	4,731.00		
14	1657	4,000.00	404.62			4,404.62		4,404.62	Jud. sale	4,000.00	164.60		797.76
15	623	30,000.00	2,165.82		370.42	32,536.24		[f] 11,913.31	Jud. sale	33,334.00	4,559.00		
	1477	9,498.80	248.69			9,747.49			Jud. sale	3,333.34	807.42		
				$2,830.76	$455.17							$302.05	$5,456.99

	a	b	c	d	e	
Book value	$9,148.35	$15,772.07	$16,200.53	$6,955.39	$36,246.22	$41,913.31
Add:						
Taxes charged to expense in error—should be capitalized	304.86	628.15	536.89		1,360.88	
Legal expense charged to expense in error—should be capitalized	84.75					370.42
Error in account	[1] 53.00					
Deduct:						
Interest capitalized in error				302.05		
Cost basis	$9,590.96	$16,400.22	$16,737.42	$6,653.34	$37,607.08	$42,283.73

[1] In 1930, $53.00 was credited against these items capitalized. This was in error, and in 1931 the entry was reversed. The book value as at Dec. 31, 1930, reflected the lower value in error. This has been adjusted in this report.

10 Before United States Board of Tax Appeals

Answer

Filed June 12, 1933

Now comes the Commissioner of Internal Revenue, the respondent herein, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition heretofore filed in this proceeding admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

4 (a) Denies the errors alleged in subparagraph (a) of paragraph 4 of the petition.

5 (a)-(f) For lack of information upon which to base relief denies the allegations contained in subparagraphs (a) to (f) inclusive of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinabove expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
L. W. CREASON,
Special Attorney,
Bureau of Internal Revenue.
6/10/33 RD.

11 Before United States Board of Tax Appeals

Memorandum opinion

Entered Sep. 11, 1934

MORRIS: The respondent having determined a deficiency in income tax of $1,232.22 for the calendar year 1930, the petitioner brings this proceeding for the redetermination thereof alleging error in such determination by reason of the refusal to permit a deduction of $5,456.99 in the computation of net taxable income for the year 1930, and in adding said amount to such net income as interest received on mortgage loans.

The petitioner is a corporation organized and existing under and by virtue of the laws of the State of Ohio with its principal place of business at 17 South High Street, Columbus, Ohio.

In his determination of the deficiency the respondent increased the taxable net income as reported by the petitioner in the amount

of $10,570.56. Such increase so added to the income reported consisted inter alia of the sum of $5,456.99 interest on mortgage loans.

During the year 1930 there was due this petitioner upon said loans secured by mortgages on real estate in the State of Michigan and Ohio, interest in the amount of $5,456.99. The books of the petitioner are, and were during the year 1930, kept on a calendar year cash basis and show in each year, including the year 1930, the cash receipts and disbursements on account of the various items of investments contained in the petitioner's assets. Only payments of interest which are, and were during the year 1930, actually made to and received by the petitioner are and were entered on the books and records the petitioner. Said loans then being in default, the petitioner during said year foreclosed its mortgages upon the real estate described in said mortgages and at the sale on foreclosure during the year 1930 did bid in, and acquire at said foreclosure sales, the said properties for amounts which were the total amounts of the principal of said loans plus the interest thereon, being $5,456.99. Upon receipt of the title to said properties so acquired by foreclosure and bid in by the mortgagee, which was this petitioner, during the year 1930, the investments were transferred on the books of the petitioner from the mortgage loan account to the real estate account of the petitioner and were carried thereon as assets of the petitioner at amounts which were equal to the principal amounts of the loans secured by said mortgages so foreclosed plus any disbursements made by the petitioner for taxes, court costs, attorney fees or insurance pre-
12 miums for the preservation of said properties, but the amount of interest included in the bid at said foreclosure sales was not carried upon the books of this petitioner as a part of the cost of said properties or as an asset of this petitioner. That is to say, the investments, on the books of the petitioner, in each of said properties so acquired included only the unpaid principal of the loan thereon and disbursements as aforesaid and did not include the interest upon said principal. Nor did the petitioner include such interest in its assets in its annual statement or convention report for the year 1930.

The instructions issued to the petitioner's representatives who have charge of the foreclosure of mortgages, in states where a period of redemption is allowed (all of the properties herein concerned being in such states) are to bid at the sale under such foreclosure proceedings in behalf of the petitioner such sum as will enable the petitioner to realize no loss on account of its investment in case a redemption should be made from the foreclosure sale and bids were and have been made accordingly. Such bids were made in 1930 in respect of said foreclosures without regard to the actual value of the property sold at such foreclosure sales, but with a view of protecting the investment in case of redemption, and there was then included in the amounts bid on behalf of the petitioner the interest which had accrued and had not been paid on the loan at the time of the foreclosure sale. The interest item included in the bid at such foreclosure sales has

never been entered on the books of the petitioner or otherwise treated by the petitioner as income. There was no competitive bidding at any of said foreclosure sales and the petitioner was the only bidder at such sales.

The properties which were acquired in said foreclosure proceedings, with dates thereof and the amounts bid by the petitioner, are as follows:

Location	Petitioner's mortgage loan number and name of mortgagee	Date of bid	Date of acquisition of title	Amount of bid
Detroit, Mich	931—Caruso	Jan. 15, 1929	Jan. 15, 1930	$10,192.08
" "	1350—Ransom	July 22, 1929	July 22, 1930	16,525.88
" "	1326—Hallam	Aug. 6, 1929	Aug. 6, 1930	18,127.03
" "	1179—Harrington	Oct. 19, 1929	Oct. 19, 1930	39,251.57
Canton, Ohio	993—Smith about	Mch. 19, 1930	Mch. 24, 1930	10,351.65
Lima, Ohio	623—Dalk "	Nov. 29, 1930	Dec. 2, 1930	33,334.00

13 Of said sum of $5,456.99 interest, the amount of $4,210.88 was interest due and included in the bid price of the foreclosure but not included in the book values of assets after acquisition of title upon loans secured by real estate located in the State of Michigan.

In determining a part of the deficiency herein the respondent included in taxable net income the said sum of $5,456.99, interest.

The question here presented, that is, whether accrued interest on mortgage loans constitutes taxable income to the petitioner when such interest has been included in the purchase price upon foreclosure of the mortgaged premises, as this petitioner concedes, has been before the Board in Reserve Loan Life Insurance Co., 18 B. T. A. 359, appealed but dismissed January 12, 1932, upon motion of parties, and Missouri State Life Insurance Company, 29 B. T. A. 401, the holding being adverse to the petitioner's contentions. The petitioner attempts to distinguish the instant case, however, on the ground that in those proceedings the petitioners had shown the accrued interest upon their books as income and had treated it as such in their annual statements and convention reports. While it is true that those factors were discussed in those opinions, the courts and this Board have, in a long line of decisions, consistently held that book entries are only evidential, are not conclusive, and furthermore that if the books of account conflict with the actual facts, such actual facts will be followed. Southern Pacific Railroad Company v. Muenter, 260 Fed. 837; Baldwin Locomotive Works v. McCoach, 221 Fed. 59; Harry N. Gifford, 3 B. T. A. 334; Luther Elkins, 12 B. T. A. 1059; Chic Brass Co., 17 B. T. A. 1199. Having already held that such amounts constitute taxable income it becomes unimportant what accounting treatment the petitioner chose to accord them.

The second distinction which the petitioner seeks to draw is that the fair market values of the properties at the date of foreclosure and when titles were acquired were insufficient to cover any part of the accrued interest thereon. This same argument was urged upon the Board in Missouri State Life Insurance Company, supra, which we answer by saying:

* * * "There is much testimony in the record upon the question of the fair market values of the properties acquired. In our view of the situation such question is not material and accordingly no
14 findings are made of those values other than that the fair market values of certain properties were less than the amount of the loan upon such properties plus accrued interest."

We have carefully considered all of the arguments presented in support of the alleged distinctions and believing, as we do, that Missouri State Life Insurance Company, supra, is controlling, and finding no reason to depart therefrom the respondent's determination that such amounts were taxable income must be approved.

Judgment will be entered for the respondent.

Before United States Board of Tax Appeals

Decision

Entered Sept. 12, 1934

Pursuant to the determination of the Board, as set forth in its memorandum opinion entered September 11, 1934, it is

Ordered and Decided: That there is a deficiency of $1,232.22 for the calendar year 1930.

[SEAL] (Signed) LOGAN MORRIS,
Member.

15 Before United States Board of Tax Appeals

Petition for review

Filed Dec. 3, 1934

Now comes the Midland Mutual Life Insurance Company, petitioner herein, and says that the Commissioner of Internal Revenue, respondent herein, determined a deficiency in petitioner's income tax of $1,232.22 for the calendar year 1930; that petitioner then petitioned this Board for a redetermination thereof, alleging error in such determination by reason of respondent's refusal to permit a deduction of $5,456.99 in the computation of net taxable income for the year 1930, and in adding said amount to such net income as interest received on mortgage loans; that this Board on the twelfth day of September, 1934, rendered a decision approving respondent's determination that said amount was taxable income and deciding that said deficiency existed, in which decision there are certain errors prejudicial to this petitioner, to wit:

1. The Board's decision is against the weight of the evidence.
2. The Board's decision is contrary to law.
3. The Board erred in approving respondent's determination and in rendering a decision in this cause for the respondent and against the petitioner.

This petitioner conceiving itself aggrieved by said decision and the errors herein assigned does hereby petition for a review of the decision of said Board in the United States Circuit Court of Appeals for the Sixth Circuit.

Wherefore, this petitioner prays that this review may be allowed and for a correction of the errors complained of; that the amount of the bond on review be fixed; and that the statement of evidence and transcript of the record, proceedings and papers upon which said judgment was rendered be made and duly authenticated, and transmitted and delivered to the clerk of the United States Circuit Court of Appeals for the Sixth Circuit sitting at Cincinnati, Ohio.

(s) FRANCIS J. WRIGHT,
(s) EARL F. MORRIS,
Attorneys for Petitioner.

16 [Duly sworn to by Geo. W. Steinman; jurat omitted in printing.]

Before United States Board of Tax Appeals

Statement of evidence

Lodged Dec. 3, 1934, filed Dec. 27, 1934

Be it remembered, that at the hearing of the above entitled cause before Honorable Logan Morris, Member of the United States Board of Tax Appeals, at Washington, D. C., on the fourteenth day of December 1933, the following proceedings were had:

Appearances: F. J. Wright, Esq., on behalf of Petitioner. Arthur Carnduff, Esq., on behalf of Respondent.

The parties made and entered into the following:

Stipulation of facts

Come now the parties by their respective counsel and stipulate and agree that the following statement of facts may be taken as true without prejudice to the right of either party to introduce further evidence is deemed material:

1. The petitioner is a corporation organized and existing under and by virtue of the laws of the State of Ohio with its principal place of business at 17 South High Street, Columbus, Ohio, and filed its income tax return for the year 1930 with the Collector of Internal Revenue for the Southern District of Ohio at Columbus, Ohio, in the 11th Collection District of Ohio.

2. The Commissioner of Internal Revenue has determined a deficiency in income tax for the year 1930 in the amount of $1,232.22, a part of which is here in issue.

17 3. In his determination of the deficiency the Commissioner increased the taxable net income as reported by the petitioner in the amount of $10,570.58. Such increase so added to the income

reported consisted inter alia of the sum of $5,456.99 interest on mortgage loans, being Item A in the notice of deficiency attached to the petition herein.

During the year 1930 there was due this petitioner upon said loans secured by mortgages on real estate in the States of Michigan and Ohio, interest in the amount of $5,456.99. The books of the petitioner are, and were during the year 1930, kept on a calendar year cash basis and show in each year, including the year 1930, the cash receipts and disbursements on account of the various items of investments contained in the petitioner's assets. Only payments of interest which are, and were during the year 1930, actually made to and received by the petitioner are and were entered on the books and records of the petitioner. Said loans then being in default, the petitioner during said year foreclosed its mortgages upon the real estate described in said mortgages and at the sale on foreclosure during the year 1930 did bid in, and acquire at said foreclosure sales, the said properties for amounts which were the total amounts of the principal of said loans plus the interest thereon, being $5,456.99. Upon receipt of the title to said properties so acquired by foreclosure and bid in by the mortgagee, which was this petitioner, during the year 1930, the investments were transferred on the books of the petitioner from the mortgage loan account to the real estate account of the taxpayer and were carried thereon as assets of the taxpayer at amounts which were equal to the principal amounts of the loans secured by said mortgages so foreclosed plus any disbursements made by the petitioner for taxes, court costs, attorney fees, or insurance premiums for the preservation of said properties, but the amount of interest included in the bid at said foreclosure sales was not carried upon the books of this petitioner as a part of the cost of said properties or as an asset of this petitioner. That is to say, the investments, on the books of the petitioner, in each of said properties so acquired included only the unpaid principal of the loan thereon and disbursements as aforesaid and did not include the interest upon said principal. Nor did the petitioner include such interest in its assets in its annual statement or convention report for the year 1930.

18 The instructions issued to the petitioner's representatives who have charge of the foreclosure of mortgages, in states where a period of redemption is allowed (all of the properties herein concerned being in such states), are to bid at the sale under such foreclosure proceedings in behalf of the petitioner such sum as will enable the petitioner to realize no loss on account of its investment in case a redemption should be made from the foreclosure sale and bids were and have been made accordingly. Such bids were made in 1930 in respect of said foreclosures without regard to the actual value of the property sold at such foreclosure sales, but with a view of protecting the investment in case of redemption, and there was then included in the amounts bid on behalf of the petitioner the interest which had accrued and had not been paid on the loan

at the time of the foreclosure sale. The interest item included in the bid at such foreclosure sales has never been entered on the books of the petitioner or otherwise treated by the petitioner as income. There was no competitive bidding at any of said foreclosure sales and the petitioner was the only bidder at such sales.

The properties which were acquired in said foreclosure proceedings, with dates thereof and the amounts bid by the petitioner, are as follows:

Location	Petitioner's mortgage loan number and name of mortgagee	Date of bid	Date of acquisition of title	Amount of bid
Detroit, Mich	931—Caru	Jan. 15, 1929	Jan. 15, 1930	$10,192.08
" "	1350—Ransom	July 22, 1929	July 22, 1930	16,525.88
" "	1336—Hallam	Aug. 6, 1929	Aug. 6, 1930	18,127.03
" "	1170—Harrington	Oct. 19, 1929	Oct. 19, 1930	39,251.57
Canton, Ohio	1093—Smith about	Mch. 19, 1930	Mch. 24, 1930	10,351.65
Lima, Ohio	623—Dalk "	Nov. 29, 1930	Dec. 2, 1930	33,334.09

Of said sum of $5,456.99 interest, the amount of $1,210.88 was interest due and included in the bid price of the foreclosure but not included in the book values of assets after acquisition of title upon loans secured by real estate located in the State of Michigan.

In determining a part of the deficiency herein at issue the Commissioner included in taxable net income the said sum of $5,456.99, interest.

CARL J. PURPUS,
Counsel for Petitioner.

E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

19 *Petitioner's case*

Thereupon, the petitioner, to maintain the issues on its part, introduced and offered the following evidence, to wit:

C. L. CONVERSE being first duly sworn, testifies as follows:

Direct Examination by Mr. WRIGHT:

My name is C. L. Converse; age 56; residence Columbus, Ohio. My business is that of a real estate broker. I have been in the real estate business since September 1905 at Columbus, Ohio. I have belonged to the Columbus Real Estate Board since its organization. In that connection, I have been a member of the appraisal board for fifteen years. I am a member and past president of the Ohio Appraisal Board. I am a member and have served on several committees of the National Appraisal Board. In my experience as a real estate man during all of these years I have had occasion to a great extent to consider the market values of real estate properties and to

make appraisement of them, and as a member of the appraisal committee of the Columbus Real Estate Board I have made appraisements of real estate in the central part of Ohio. From my experience in considering the values of real estate properties, and making appraisements, I am, in my opinion, competent to testify as to the value of real estate properties.

I am familiar with certain properties located in Detroit, Michigan, which you have referred to in your stipulation as the petitioner's mortgage loan No. 931, the mortgagor's and owner's name being Caruso; and mortgage loan No. 1350, the owner being Ransom; and mortgage loan No. 1926, the owner being Hallam; and mortgage loan No. 1170, the owner being Harrington. With reference to how I became familiar with them and the extent to which my knowledge concerning these properties goes, I will state that in 1921 I took a part-time or *per diem* place with The Midland Mutual Life Insurance Company to inspect their loans on properties out of the City of Columbus. I made trips from three to six times a year, in most of the cities in which they had loans, Detroit, Toledo, Cleveland, Canton, and Lima.

I am familiar with the properties which you have listed in the stipulation at Petitioner's Mortgage Loan No. 1093, the owner being Smith, and the properties in Lima which you have listed as mortgage loan No. 623, the owner being Dalk. I knew them before and after. I have examined, from time to time, all of these properties. I am familiar with their location and the type of properties they are.

From my knowledge of these properties, their location and the type of properties they are, and other facts I have concerning these properties, I am in a position to tell what, in my opinion, the fair market price of those properties, respectively, were in 1929 and 1930. In my opinion the fair market value of the Caruso property on or about January 15, 1929, was $8,500, and on or about January 15, 1930, there was a slight decrease, if anything. In my opinion the value of the Ransom property on or about July 22, 1929, was $15,000, and on or about July 22, 1930, it was practically the same. I have had some additional information in regard to property about that time that it was worth less money than it was in 1929. My opinion as to the value of the Hallam property on or about August 6, 1929, is $16,000, and on or about August 6, 1930, it was practically the same. My opinion as to the fair market value of the Harrington property on or about October 19, 1929, is $37,500, and that on or about October 19, 1930, there had been practically no change. My opinion as to the fair market value of the Smith property in Canton, Ohio, on or about March 24, 1930, is $7,500. My opinion as to the fair market value of the Dalk property in Lima on or about December 2, 1930, is $30,000. I am familiar with these properties as of the present time. They are all still owned by The Midland Mutual Life Insurance Company;

four of them are in different companies, but the stock is controlled by the Midland Mutual Life Insurance Company.

Mr. WRIGHT. Cross-examine.

Cross-examination by Mr. CARNDUFF.

I personally examined each and every one of these six pieces of property, four in Michigan and two in Ohio, during the years 1929 and 1930, and either immediately before or immediately after the time of the foreclosure, when my business called me to Detroit or Lima or Canton or the vicinity of those properties. I remember distinctly that, in regard to Canton, it was probably three or four months after the foreclosure that I reinspected the property.

21 The purpose of my inspection during 1929 and 1930 was simply to keep track of the properties of the Midland, that the Midland had loans on, that were not collected. I knew the unpaid principal amount of that loan or mortgage, approximately, only, at the time I inspected the property. I had an approximate idea of how much was owing to the Midland Company on these properties.

I said I thought the Dalk property was worth $30,000. I do not remember, I do not know, the unpaid amount of the principal of the loan at that time. In explanation, that is a four story brick building 60 by 70 feet. It was a very light construction, which was leased to the Oden Cigar Company and they had tables of women rolling cigars there. Along in 1926 or 1928, the cigar machine came out and that building was of too light structure to carry the machines. The Oden Cigar Company was sold out to a Detroit concern. They took the building. One thing that caused my judgment on that was that an adjoining building had a lease with a clause in it permitting ingress and egress to this building. There is absolutely no way of breaking that lease. They do not have to pay taxes on it, or anything, and still they have the right to go through that building. I do not know how much rent was paid on that building. My estimate was not based on rental because there was none at that time. I do not know the assessed valuation. I have never looked it up. I would say the cubical contents of that building were some place in the neighborhood of 400,000 to 500,000 cubic feet. I had a builder there give me a report on it for insurance alone, this last year, and he gave me a valuation as of 1933 of $21,000. The frontage is 60 feet on one street and 70 feet on another: that is on the corner of North and Central Streets in Lima. That is not the business district; it is more of a wholesale district. The lot is worth not to exceed $9,000. My estimate of $30,000 for the building, in 1930, was predicated approximately $10,000 for the lot and $20,000 for the building. It was a four story building, the full size of the lot, built of brick, and from twelve to fifteen years old. It would carry about 50 pounds per square foot—very light construction.

I said the Smith building in Canton was worth $7,500 at the time we bought it. It is a narrow two story building, a store room on the

first floor, and a five-room flat above. It is possibly 25 by 60 feet in depth. It was in horrible condition. It had been used and occupied by the bootlegger king of Canton. I do not know what he
22 paid as rental for it. He was supposed to own it, and the foreclosure was against this Smith, the bootlegger.

I did not inspect all of these buildings at the time the loans were made by the Midland. I inspected the Dalk property, but not the Smith property. The lease was made on that Dalk property in 1923. They loaned approximately $30,000 on it at that time. I do not know whether any of the principal was paid on it. Owing to my connection with the Insurance Company, I have rather make a study of cities and conditions, and Lima, commencing with the fall of 1925–1926, was one of the first towns to feel the slump, and we made no loans in Lima from at least 1927 on, on account of that.

I said the Ransom property in Detroit was worth $15,000 in 1929 or 1930. I do not know what the amount of the loan was in 1930. The Ransom property was located at 605 Atkinson Avenue, the corner of two boulevards, which is about one and one-half miles north of Grand Boulevard, where the Fisher Building is. There is a terrible lot of traffic there. It is a very old house; brick, the first story, and shingles, the second. Unfortunately, it is restricted to single residences only, and with the immense amount of traffic of two boulevards, with the trend to the outlying districts, the property was worth no more than $15,000 in 1929 or 1930.

The Harrington property in Detroit is an apartment house, located on what is known as West Grand Boulevard. It is approximately three miles from the center of downtown and is on what was known as the lower or worst section of the West Grand Boulevard. It was a brick building consisting of eleven two-room apartments, seven three-room apartments, and was in rather a deplorable condition. In Michigan they have one year to redeem the property. During that year they do not pay anything, taxes, water rent, or anything, and the Insurance Company had to pay—I can't tell you how much money—to put it in shape. The amount of the value was $37,500. I do not know how long it ran. If you were to tell me there was out on this property a principal at that time of foreclosure of $34,200, I would not think that would be a fair amount for loans on that property. I would have been willing to have loaned on that property on the basis that it was worth $37,500. I did not know what the principal was. I inspected the property sometime in 1928 and again in 1929. I do not believe I ever saw Exhibit A, a photostat sheet attached to the petition in this case, describing these loans. It was not prepared under my supervision.

23 Mr. CARNDUFF. That is all.

The MEMBER. Is there any redirect?

Mr. WRIGHT. No, sir.

The MEMBER. You are excused.

Mr. WRIGHT. Petitioner rests.

The MEMBER. Has respondent any further evidence to offer?

Mr. CARNDUFF. Respondent rests, and at this time moves for judgment on the evidence.

The MEMBER. The motion will be taken under advisement.

Approved and ordered filed this 27th day of Dec., 1934.

(s) LOGAN MORRIS,
Member.

Before United States Board of Tax Appeals

Praecipe for transcript of record

Filed Dec. 3, 1934

To the Clerk:

Please prepare transcript of the record in the above entitled cause for transmission to the United States Circuit Court of Appeals for the Sixth Circuit for review. In making up such transcript please deliver to for the purpose of printing, the following pleadings and documents in said cause, to wit:

1. The docket entries of proceedings before the Board.
2. Pleadings before the Board.
3. Memorandum opinion, and decision of the Board.
4. Petition for review.
5. The statement of evidence.

(s) FRANCIS J. WRIGHT,
(s) EARL F. MORRIS,
Attorneys for Petitioner.

24 [Clerk's certificate to foregoing transcript omitted in printing.]

25 In United States Circuit Court of Appeals for the Sixth Circuit

Minute entry

Cause Argued and Submitted April 9, 1936

Before MOORMAN, HICKS, AND SIMONS, JJ.

This cause is argued by Earl F. Morris and Edward W. Merkel for Petitioner and by Helen Carloss for Respondent and is submitted to the Court.

In United States Circuit Court of Appeals

Decree

Filed May 6, 1936

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is, hereby reversed and remanded for further proceedings, consistent with the opinion of this Court.

26 [Omitted.]

27 [File endorsement omitted.]

In United States Circuit Court of Appeals, Sixth Circuit

No. 7001

THE MIDLAND MUTUAL LIFE INSURANCE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition to review decision of United States Board of Tax Appeals

Opinion

Filed May 6, 1936

Before MOORMAN, HICKS, and SIMONS, Circuit Judges

SIMONS, Circuit Judge: The sole question involved in this review is whether accrued interest on defaulted loans secured by mortgages constitutes taxable income to the mortgagee by virtue of its having bid in the properties at foreclosure sales for the debts and interest, when the fair market value of the properties was less than the bids. The respondent made a determination of a deficiency in the petitioner's computation of net taxable income for 1930 by adding to such net income the accrued interest on certain mortgage loans in that year foreclosed. The Board of Tax Appeals sustained the determination nothwithstanding undisputed evidence that fair value was less than the total of the debt including interest.

The petitioner is a life insurance company, and kept its books on a calendar year cash basis. Only those payments of interest which were actually received were entered thereon. In 1930 it foreclosed certain Michigan and Ohio mortgages, and at the sales bid in the various parcels for amounts equalling the principal of the

28 loans plus the accrued interest. Its purpose in so doing was to secure itself against loss in the event of redemption, the local law in each case making provision for such redemption by the mortgage debtor. Upon receipt of title to mortgaged property the petitioner transferred the investment on its books from the mortgage loan account to the real estate account, and carried it upon its books in an amount equalling the principal of the loan, plus cost of fore-

closure, but exclusive of interest. No unpaid interest was carried as an asset either in the petitioner's annual statement or in reports to insurance departments. The bids in respect to the real estate here involved were made without regard to the actual value of the property, and at each sale the petitioner was the only bidder.

The deficiencies were asserted by the respondent, determined by the Board, and are now supported upon review on the ground that a bid at foreclosure sale by the mortgagee establishes the market for the particular property sold and is determinative as to receipt of income by the mortgagee. This is because the legal effect of such sale is said to be the same as though the mortgagee paid the full amount of its bid in cash and then received in cash the full amount of its debt, so that interest is received by it in cash or its equivalent. This view is supported not only by prior decisions of the Board, but by the Court of Claims in National Life Insurance Co. v. United States, 4 Fed. Supp. 1000, certiorari denied Lucey v. United States, 291 U. S. 683, and by the Court of Appeals of the Eighth Circuit in Missouri State Life Insurance Co. v. Helvering, Commissioner, 78 Fed. (2d) 778.

With profound deference to the courts which have considered the problem, we are unable to accept their reasoning. Whatever may be the legal effect of a foreclosure sale upon the passing of title and the extinguishment of the mortgage debt, the fact indisputably remains that when the mortgagee buys in the property he does not pay cash. The law permits him to set off the debt against the obligation created by his bid. This distinction is vital in determining whether he has received income. Without possessing the debt the mortgagee would not bid. He is primarily a lender and a purchaser only through necessity. To say that he pays cash and receives cash is to fly in the face of the realities. A mortgage lien upon property of a defaulting mortgagor is generally worth no more than the fair value of the security. It is true that the law invests it with the virtue of
29 currency, but only for a limited and definite purpose—the purchase of the mortgaged property. We are unable to see by what alchemy this baser metal is transmuted into gold through the mere formalities of a foreclosure sale.

Income has been defined as "The gain derived from capital, from labor, or from both combined." Stratton's Independence v. Howbert, 231 U. S. 399, 415; Doyle v. Mitchell Bros. Co., 247 U. S. 179, 185. Approved and analyzed was this definition in Eisner v. Macomber, 252 U. S. 189, 207. "Here," said the court, "we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal;—that is income derived from property. Nothing else answers the description." It is said on be-

half of the respondent that by bidding the full amount of its debt the mortgagee secured protection against the mortgagor's redemption; that having acquired a benefit it should pay the tax regardless of the value of the property. But a benefit is not necessarily income. That need not be demonstrated. Here it is clearly not a gain derived from capital, or received or drawn by the taxpayer for its separate use, benefit and disposal. The property may be redeemed. In that event income is derived to the extent of interest included in the redemption price. Then interest is paid, and likewise received. But the property may not be redeemed. Is the realization in the one case no more in respect to the creation of income than mere expectation in the other? We think to put the query is to answer it. As was further said in Eisner v. Macomber, "It becomes essential to distinguish between what is and what is not income . . . ; and to apply the distinction, as cases arise, according to truth and substance, without regard to form."

There is urged upon us the existence of a presumption that at foreclosure sales the bid price is the fair market value of the property. Whether so or not, and this we do not decide, certainly the presumption by all familiar rules must disappear in the face of unchallenged and uncontroverted evidence that the fair value of the property is less. We know neither reason nor authority for such presumption being given conclusive effect. If so foreclosure sales could never be set aside for inadequacy of price, however gross or shocking to the conscience such inadequacy might be.

30 The court in Helvering v. Missouri State Life Insurance Co., supra, made a distinction between surrender of mortgaged real estate by the mortgagor to the mortgagee and the purchase of the property by the mortgagee under foreclosure. It concluded that a transaction of the first kind produces no income by way of interest to the mortgagee, while one of the latter does. We are unable to grasp the principle which distinguishes them, and we think the differentiation will not withstand analysis. Where the defaulting mortgagor surrenders the mortgaged property in extinguishment of the debt, the mortgagee acquires as against him a clear title. Where the mortgagee buys the property at foreclosure, he does not get clear title, but one still encumbered by the mortgagor's right to redeem. It seems to us anomalous to hold that one who receives less derives income, while one who receives more derives none. Demonstrating its conclusion that the recipient of the surrendered mortgage derives no income from accrued interest, the court says: "If the rule were otherwise, a life insurance company, all of the loans of which were in default and which was obliged to take over from its mortgagors mortgaged lands of little value in order to save the expense and delay of foreclosure, would be in the same situation with respect to interest received as though all of its loans were good and the interest had been paid in cash." We fail to see in what better situation is a life insurance company which not only is obliged to take over from its mort-

gageors lands of little value, but is in addition subjected to the expense and delay of foreclosure. If the illustration is persuasive in the one case, we are unable to see how it can be any less so in the other.

The theory of constructive receipt of income is not here applicable.

The decision of the Board is reversed. Conceiving it to be immaterial, the Board made no finding of fair value in respect to the foreclosed properties. Proper disposition therefore requires that the cause be remanded for further proceedings consistent herewith.

31 [Clerk's Certificate to foregoing transcript omitted in printing.]

32 Supreme Court of the United States

Order allowing certiorari. Filed October 12, 1936

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 40,797. U. S. Circuit Court of Appeals, Sixth Circuit. Term No. 257. Guy T. Helvering, Commissioner of Internal Revenue, petitioner vs. The Midland Mutual Life Insurance Company. Petition for a writ of certiorari and exhibit thereto. Filed August 4, 1936. Term No. 257 O. T. 1936.

U. S. GOVERNMENT PRINTING OFFICE: 1936